long distance carriers likewise recognize that Bell companies could offer consumers the fruits of "integrative efficiency" in the marketing, billing and customer support for the provision of local and long distance services."[18] And there certainly is room for more competition in the long distance market that Bell companies seek to enter, as Congress,[19] the Commission,[20] and the Department of Justice[21] have suggested.

In addition to these efficiencies, however, Bell company entry would bring additional benefits that are not possible through the BT/MCI merger. Bell companies would be new competitors in the marketplace. By contrast, BT merely intends to provide MCI with additional

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[18] Letter from David W. Carpenter, Counsel for AT&T, to Don Russell, Chief, Telecommunications Task Force, Antitrust Division, Department of Justice, 11 (Dec. 13, 1996) ("AT&T DOJ Comments") (Ex. 9 hereto).

[19] Legislators who crafted the 1996 Act concluded that the long distance industry is "oligopolistic." 141 Cong. Rec. S7881, S7889 (daily ed. June 7, 1995) (statement of Sen. Pressler); see id. at S7906 (statement of Sen. Lott) (long distance industry displays "at best, limited competition"); see also S. Rep. No. 23, 104th Cong., 1st Sess. 5 (1995) ("By opening up local telephone service and long distance to competition, the Committee anticipates consumers will have a greater choice of services and providers."); 141 Cong. Record S704 (daily ed. Feb. 1, 1996) (Statement of Sen. Ford) (noting estimated savings of $333 billion from greater long distance competition).

[20] See Non-Accounting Safeguards NPRM ¶ 6 (Bell company provision of in-region interLATA services "offers the prospect of increasing competition among providers of such services"); Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271; 3313-15, ¶¶ 81-83 (1995) (finding that AT&T, MCI, and Sprint may be engaged in non-competitive, cooperative pricing).

[21] The Department has concluded that competition in the long distance business is "imperfect" and there is "room for more competition." Memorandum of the United States in Response to the Bell Companies' Motions for Generic Wireless Waivers at 22, United States v. Western Elec. Co., No. 82-0192 (D.D.C. filed July 25, 1994) (Ex. 10 hereto); Statement of Assistant Attorney General Anne K. Bingaman 6, The Antitrust Reform Act: Hearings on H.R. 3626 Before the Subcomm. On Economic and Commercial Law of the House Comm. On the Judiciary, 103d Cong., 2d Sess. (1994).

funds, expertise, and buying power that may bolster MCI's existing domestic long distance operations and its already-established local business. See Applications and Notification at 8-11. In international markets, moreover, the BT/MCI merger would leave consumers with one fewer provider.

Furthermore, Bell companies will bring to in-region interLATA services "a widely recognized brand name that is associated with telecommunications services." Non-Accounting Safeguards NPRM ¶ 6. The Commission has considered this pro-competitive factor important to the public interest analysis in other merger-related proceedings.[22] Yet MCI's affiliation with BT cannot achieve any such beneficial synergy: U.S. customers are unfamiliar with BT, while British consumers are unfamiliar with MCI. That apparently explains why BT and MCI have decided that neither name is worth raising to the masthead. See Applications and Notification at 4-5 (merger will form "Concert plc").

Finally, while the benefits of a liberal foreign investment policy are well recognized, it should be acknowledged that the Bell companies are domestic corporations whose successes would benefit shareholders in this country rather than predominantly foreign investors. See Applications and Notification at 6 (foreign investors to hold 65% of Concert stock). Accordingly, even if the proposed merger offered consumers the same sort of advantages as Bell company entry pursuant to section 271, it would provide substantially less benefit to the American economy generally. If BT's acquisition of MCI is consistent with the public interest, it is inconceivable that the public would not also benefit from the entry of domestic competitors to

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[22] See Applications of Craig O. McCaw, 9 FCC Rcd 5836, 5871-72, ¶ 57 (1994) (finding that AT&T acquisition of McCaw would serve public interest due in part to AT&T's brand name).

prevent the foreign-owned BT/MCI (and its co-oligopolists in the long distance business) from continuing to earn supracompetitive profits at the expense of American customers.

CONCLUSION

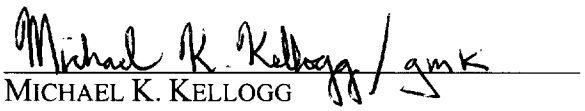
There is considerable irony in the proposed BT acquisition of MCI. MCI has vigorously opposed Bell company entry into long distance, while insisting that U.S. LECs be required even to subsidize entry by long distance companies and others to facilitate competition in the local exchange. On the other hand, while the United Kingdom has authorized competition in all telecommunications markets, it has imposed a very minimal interconnection obligation on BT, the formerly government-owned, monopoly provider of local and long distance services. BT has no obligation to permit resale of its services, no obligation to unbundle its network, no obligation to provide equal access arrangements, and no obligation to provide the whole list of services and functions that are a part of the duties imposed on LECs in the United States. Bell companies and other U.S. carriers are competing with BT in the United Kingdom under these rules.

Now, BT is seeking, by acquiring MCI, to take advantage of U.S. laws which require American LECs to provide all means of assistance to competitors in the United States. We do not object to increased competition in all U.S. markets, nor even to the fact that BT's own obligations in the United Kingdom are limited to minimal interconnection with competitors. But, it would be the height of folly to let BT come to the United States and take from American LECs services that BT has no obligation to provide in the United Kingdom — and then protect BT from interLATA competition by these same domestic carriers.

This application makes manifest the wisdom of Congress decision to open all markets to competition. The Commission should not permit BT to acquire an American carrier, take advantage of the significant obligations imposed on the Bell companies and other U.S. LECs, and have free rein in the U.S. long distance market while American companies are denied freedom even to compete.

Simply stated, BT/MCI cannot block the Bell companies' entry into the U.S. long distance market with arguments that MCI rejects in the context of the British market. By the same token, if the Commission approves this merger, it will have conclusively determined that Bell companies' entry into the U.S. interLATA market will also benefit competition and consumers.

Respectfully submitted,



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January 24, 1997

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Joel Jacobs	Chair
Marshall Johnson	Commissioner
Dee Knaak	Commissioner
Mac McCollar	Commissioner
Donald Storm	Commissioner

In the Matter of an Investigation Regarding US West Communication Inc.'s Compliance With Section 271 of the Telecommunications Act of 1996 with Respect to Provision of InterLATA Services Originating in Minnesota	DOCKET NO. P-421/CI-96-1114

COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION REGARDING THE REQUIREMENTS FOR INTERLATA ENTRY UNDER SECTION 271

November 25, 1996

IV. THE PUBLIC INTEREST TEST

The public interest test is and always has been a broad standard. As construed by the FCC and the courts, a critical element is how any grant of the requested authority would affect competition in any affected market. See FCC v. RCA Communications, Inc., 346 U.S. 86, 90, 91 (1953); United States v. FCC, 652 F.2d 72, 81-82 (D.C. Cir. 1980) (en banc); MCI Communications Corp., British Telecommunications plc - Joint Petition for Declaratory Ruling, 9 FCC Rcd. 3960, 3965 & n.54 (1993). Applied in the present context, it focusses on whether grant of an in-region application will, on balance, produce benefits for consumers in the short and long term by creating, preserving, and enhancing competition in exchange and interexchange markets. The FCC must therefore determine whether BOC entry can be approved without (1) frustrating future development of competition in the BOC's local market, or (2) rolling back existing competition in the interLATA market.

A. Effective local competition

As explained in Part I above, the principal factor that will determine whether BOC entry can be accomplished consistent with the public interest relates to the effectiveness of actual competition in local markets. As also explained above, Track A should be interpreted to require significant facilities-based local competition. But even if that provision is construed more narrowly, local competition must still be evaluated under the public interest test.

Simply put, without a significant degree of actual local competition, it would be contrary to the public interest to allow any BOC to provide in-region long-distance service. If local competition is sparse and embryonic, it will not provide an adequate check on the BOC's ability and incentive to use its bottleneck power to stymie competition, and fragile local competition may not survive the removal of any incentive created by section 271 for the BOCs to cooperate with would-be local competitors. Local competition must be sufficiently vibrant in a sufficiently large geographic area within a state to reduce the dependence of telecommunications carriers on the BOC to a point where the BOC's ability to leverage its bottleneck power is significantly

reduced and where enforcement of section 272 safeguards can effectively control abuse of any remaining bottleneck power.

Consistent with these principles, the legislative history demonstrates persuasively that Congress expected the FCC to focus heavily on the extent of competition in the local market. See supra (discussion of legislative history). Congress unquestionably intended section 271 to incorporate a requirement that real, effective competition in the local market precede BOC interLATA entry.

The very existence of a "public interest" test in the Act reflects a legislative judgment that a BOC's satisfaction of the checklist does not prove the existence of real competition, and that more is required before BOCs should be granted interLATA entry. Congress' inclusion of the public interest test demonstrates that it intended truly effective competition to have taken hold before the BOCs would be allowed into long distance. Although it increases the likelihood that effective local competition will develop over time, full implementation of the checklist does not necessarily guarantee that such competition will exist at the time that a BOC applies for authority to provide in-region long-distance services.

From the beginning, the Senate bill included the public interest test as a condition of FCC approval of a BOC's entry into long distance. The well-understood effect of this public interest test was that the FCC could deny a BOC's application for entry despite its full implementation of the competitive checklist. Senators Burns, Packwood, and McCain all complained in their "Additional Views" and "Minority Views" following the Senate report that the test gave the FCC too much discretion. S. Rep. No. 23, 104th Cong., 1st Sess. 62, 70 (1995). Senator Hollings, on the other hand, approved the public interest test precisely because of that discretion. Id. at 67. Conversely, the absence of a public interest test in the House bill left too little assurance that true local competition would be realized before BOC entry occurred. See 141 Cong. Rec. H8458 (daily ed. Aug. 4, 1995) (statement of Rep. Bunning) (emphasis added) ("We should not allow the regional Bells into the long distance market until there is real competition in the local business and residential markets."). Faced with these concerns, the Conference Committee

retained the "public interest" provision of the Senate bill. That decision was made to ensure that effective local competition would precede BOC long distance entry.

The public interest test also includes, as the BOCs contend, consideration of the effect of Bell entry on competition in the interexchange market. The alleged benefits as well as costs of BOC entry into the long-distance market should be examined. But it flies in the face of the structure and purpose of the Act for the BOCs to claim consideration under the public interest test is limited to the effect of entry on interLATA competition. The Conference Report's statement that the FCC must consider "whether the provision of the requested interLATA services is consistent with the public interest" does not imply that only effects on the interLATA market are relevant. Because any objective evaluation of the state of long-distance competition demonstrates intense and effective rivalry, BOC entry will not increase the intensity of this competition. Accordingly, the decisive issue is whether competition in the local exchange markets eliminates the ability and incentive of the BOCs to obstruct this vibrant interexchange competition.

Whether enough local competition exists to reduce the risks of BOC long distance entry to tolerable levels depends on a variety of factors:

- the percentage of local customers that have actually switched to competitive carriers
- the percentage of local customers that could readily subscribe to competitive services equivalent in functionality, quality, and price to those of the BOC
- the extent to which new entrants have constructed their own networks using their own facilities, including the extent to which those costs are irrevocably committed (that is, sunk) and to which new entrants have control over the design of new service through their own switches or otherwise
- the extent to which new entrants can expand service to new customers in new areas without sinking additional resources
- the extent to which new entrants have achieved economies of scale and scope
- the extent to which the BOCs have unbundled network elements that it is not technically feasible to unbundle immediately

- the extent to which a permanent arrangement for local number portability has been implemented
- the extent to which universal service subsidies are collected, distributed, and administered on a competitively neutral basis
- pricing behavior of the BOCs, in particular whether they have responded to competitive entry in portions of the market by strategically targeted price reductions

The best evidence of competition is that new entrants have captured market share. While market share is not necessarily dispositive, it provides a telling indication of the strength of competition. See, e.g., United States v. Grinnell Corp., 384 U.S. 563, 571 (1966); Weiss v. York Hospital, 745 F.2d 786, 827 (3d Cir. 1984), cert. denied, 470 U.S. 1060 (1985); Price Cap Performance Review for Local Exchange Carriers, 11 FCC Rcd. 858, 922 (1995). Accordingly, it would be appropriate to use market shares to establish rebuttable presumptions about whether local markets are, or are not, competitive.

In this approach, the FCC could presume that actual competition is not effective unless at least a specified percentage of business or residential customers in a state have switched to competitive LECs, or, alternatively, if a substitutable CLEC service equivalent in type, quality, and price is as readily available as BOC service to a higher percentage of these customers, even though they have not actually switched. For a CLEC's service to be equally available, it is not enough that the CLEC's network pass within a specified distance of businesses or homes: the cost of extending the CLEC network even another hundred yards to the customer premises may be prohibitive; and in the case of multi-tenant buildings, it may be impossible at any price. CLEC service is not equally available unless the CLEC can provide service within the same amount of time at the same price as the BOC. The BOC would also have to produce evidence of actual competitive offerings that customers purchase and use as substitutes for BOC local service. These presumptions would be rebuttable. A BOC could attempt to demonstrate, for example, that even though it had virtually a 100% market share throughout a state, effective local

competition existed. But the burden of proof on the BOC would be even heavier than it would otherwise be.

Conversely, if more than a specified percentage of business or residential customers in a state have switched to competitive LECs, or if a substitutable CLEC service equivalent in type, quality, and price is as readily available as BOC service to a higher percentage of these customers, the FCC could presume that actual competition is effective. A BOC might be able to carry its initial burden of proof by showing that its state-wide market share had fallen below these levels, but other parties could rebut that presumption by showing, for example, that these figures are misleading because many customers in substantial portions of the state have no real competitive alternative.

B. Other considerations

Although the extent of local competition will be a principal consideration in the public interest inquiry, it is not the only one. Two related factors deserve specific mention.

First, the public interest requires that access charges be reduced to economic cost before BOC entry. The Minnesota Commission will, in fact, soon begin its investigation of access charges. For the reasons explained above, compliance with the competitive checklist in subparagraph (c)(2) requires reduction of access charges. But even if the competitive checklist were interpreted more narrowly, it would be contrary to the public interest to allow the BOCs to provide in-region long distance service while access charges remain significantly above the economic cost of providing exchange access. As explained above, permitting the BOCs to provide long distance service while access charges remain at their current inflated level would substantially increase their ability and incentive to impede both local and long distance competition. This does not mean that the BOCs must wait to submit applications under section 271 until the FCC's promised access charge reform proceeding is completed no later than next spring. Under the FCC's price cap rules, nothing prevents the BOCs from reducing access charges sooner.

THE EFFECTS OF BOC LONG DISTANCE ENTRY ON COMPETITION IN LOCAL AND LONG DISTANCE MARKETS:

Responses to Questions from the Department of Justice

MCI COMMUNICATIONS CORPORATION

December 13, 1996

localized evidence of competition. First, such competition does not affect access (or the possibility for discrimination) at the other end of the call. Second, local competition may well develop along very narrow and geographically focused lines, in which case the emergence of competition in one city does not imply competition will soon emerge elsewhere.[7/] As a result, a new entrant cannot effectively negate this advantage through calling plans (like MCI's "Friends and Family") that give the calling party better prices if the called party subscribes to the same carrier; that response cannot succeed if the carrier can serve only a small percentage of the BOC customers called by the carrier's local customers.

Regulators cannot effectively prevent the BOCs from acting on these anticompetitive incentives. For example, while an active regulator might hope to prevent overt acts of commission, regulators cannot enforce cooperation. IXCs require cooperation from the BOCs so that access arrangements work properly and especially that they evolve as they should in a technologically dynamic industry. As a practical matter, regulation cannot prevent acts of omission, such as failure to treat unaffiliated and affiliated companies the same with respect to R&D projects, or failure to fund capital projects that benefit a long distance rival at the expense of the BOC's own long distance affiliate. Regulatory proceedings to enforce nondiscrimination requirements in this context are necessarily protracted and expensive, and any relief, if it comes soon enough to do any good at all, is likely to be prospective only. The result is that the BOC gains the advantage of delay.

For example, consider what will happen when an IXC needs the technical cooperation of a vertically integrated BOC to introduce technical changes in access arrangements, either in the form of capital expenditures or collaboration with the BOC on technical interconnection issues. Once the BOC begins to compete in long distance, it will withhold cooperation because any new competitive success by rival IXCs will come, in part, at the expense of the BOC's long distance unit. Even in the absence of conflicting incentives, upstream and downstream companies are sometimes unable to reach agreement on technical collaboration, perhaps because they have differing views on the technical merits of a project or on the allocation of costs among the parties. It would generally be extremely difficult to determine that the BOC's failure to cooperate with an IXC in a given instance was due to anticompetitive motivation rather than to an ordinary commercial disagreement. This uncertainty is particularly important because it makes the regulator unwilling to impose tough penalties on a BOC if and when the regulator does decide that the company probably has behaved anticompetitively. If a regulator cannot severely punish bad behavior, it must catch every violation, requiring significantly greater, and more intrusive and costly, regulatory oversight.

[7/] For example, on page 4 of its 1995 Annual Report, U S West stated: "Our region is not an easy one for local-service competitors to enter. Customers are scattered throughout our 14 states, and our strongest growth is centered outside our top-five metro areas. Many of our fastest-growing cities are in hard-to-serve areas, where the cost to duplicate our network would be prohibitive." (Emphasis added.)

OFTEL'S POLICY ON INDIRECT ACCESS, EQUAL ACCESS AND DIRECT CONNECTION TO THE ACCESS NETWORK: STATEMENT FROM THE DIRECTOR GENERAL OF TELECOMMUNICATIONS

Introduction

1. All telecommunications customers in the UK have to be directly connected to at least one operator by a wire, fibre-optic or radio link to connect that customer to a public telecommunications network. The majority of customers are connected to BT. However, many of BT's customers also have access to services provided by a second operator via the BT system using an indirect access code. The term 'indirect access' is often used in different ways. Here, it is used to mean only the situation where a customer contracts to buy a telecommunication service from an operator to which the customer is not directly connected and where the second operator pays the first operator for the use of that connection.

2. This Statement sets out the policy within which BT and other operators should be obliged to provide such 'indirect access' and whether the obligations should be further enhanced to cover 'equal access', where the customer pre-selects the indirect access operator or where there is parity in the number of digits to be dialled (dialling parity), eg dialling 'wxyz' for calls over the first network and 'abcd' for calls over a second network.

3. This Statement also considers the possibility of operators being allowed to connect directly to BT's Access Network, that is connect to a point between the customer's premises and the local exchange (sometimes known as the local loop). In this way, operators would be able to take over BT's customers using part of BT's Access Network and the customer would no longer be directly connected to BT's system.

4. This Statement indicates OFTEL's policy taking into account the current development of the telecommunications market and considering where the balance of economic benefit lies. However, that position could change over time as markets develop both nationally and internationally.

5. OFTEL recognises that the issues addressed herein are very important to the industry and welcomes comments on any aspects of the Statement: (see paragraphs 48-9).

The role of indirect access in the development of competition in the UK

6. In the early 1980s, that is at the time of BT's privatisation and the establishment of the current regulatory regime for telecommunications in the UK, the Government took the view that telecommunications policy should be to encourage competition based on the establishment of competing infrastructure at all levels of the market. This would allow the telecommunications market to develop in the most efficient way and gradually allow the level of regulation to diminish as market forces prevailed throughout the entire telecommunications network. Nevertheless, the Government recognised that it would take some considerable period for competing infrastructure to develop, particularly in the Access Network, and concluded that allowing indirect access would be a useful

means of extending the footprint of competition. It would, in effect, enable customers to access indirectly what competing infrastructure there was. The Government therefore included within BT's (and Mercury's) initial licence provisions a requirement that they provide competitors a facility enabling their customers to access new operators' networks for the purpose of providing competing long-distance and international services.

7. With the duopoly review in 1991, the Government saw no reason to continue treating the local and long-distance markets differently. By ending the domestic duopoly and encouraging cable companies and others to enter the market, it established a framework for such competitors to build their own Access Networks, providing for the first time substantial competition to BT in the provision of direct connections to customers.

8. At the same time, however, the Government recognised that indirect access could continue to offer an important source of competition. It therefore included the same interconnection (and indirect access) requirements in the licences of the new public telecommunications operators (PTOs) and extended, subject to a cost benefit analysis, indirect access provisions in BT's and Mercury's licences applicable to Long Line Operators to include 'Equal Access'. A summary of these provisions is included at Annex A.

9. 'Equal access' can mean different things. In the UK, the existing indirect access arrangements require a customer to dial extra digits or follow additional procedures in order to route calls over the second operator's network. 'Equal access', as defined in the 1991 BT licence modifications (Condition 13A), means the substitution of such an arrangement by one in which there is parity in the number of digits to be dialled or other procedures to be followed in order to route a call over either BT's or the second operator's network.

10. In the United States, where equal access arrangements have been put in place, a different approach is used where the customer is balloted and elects to route long-distance or international calls via a chosen carrier for a given period. (However, it should be noted that the market structure in the US is rather different from the UK as in most cases the local operator is not itself competing in the long distance and international markets).

11. It is important to distinguish between this and any wider meaning of equal access. Some discussion papers and consultants' reports commissioned by various agencies of the European Union and the OECD have used 'equal access' in a much wider sense - the provision of transparent and non-discriminatory terms and conditions for interconnection, for instance. In this document, 'equal access' has a meaning similar to the expression 'dialling parity' used in some of those European documents, the effect of which is described in paragraph 9.

OFTEL's policy in relation to indirect access over the BT network

12. As noted above, the initial focus of indirect access arrangements was in relation to BT's customers. The market for indirect access may be divided into separate markets for residential users and business users. In the residential market, indirect access penetration is around 3% of the market. The numbers of residential customers who take indirect access have now begun to fall, albeit slowly, due to increased competition for the higher spending residential customers, both from BT and cable

operators. In the business market, over 13% of customers use indirect access, and the numbers are growing as both the alternative national networks, Mercury and Energis, and resellers such as Worldcom and ACC continue to use indirect access to access the majority of their customers.

13. OFTEL is optimistic that an increasing proportion of the market for direct connections will be contested by other operators over the next few years. Mercury and other operators are now increasing their number of directly connected customers and cable operators, in particular, will have extended their local networks to cover about 75% of UK homes within the next five years. In the meantime, indirect access will remain an important route for many customers who are not in the footprint of competing operators to receive the benefits of competitive telecoms provision. OFTEL takes the view that indirect access arrangements over BT's network are appropriate given its dominant position in the Access Network. Conversely, OFTEL considers that it is not appropriate for operators without significant market power are to be obliged to allow indirect access over their direct connection as further explained in paragraphs 26-33.

Levying of fees for indirect access

14. The requirement on BT to provide indirect access raises some issues about the economic basis on which this should be done. Historically, BT's tariffs have been unbalanced - typically, the rental and connection charges have earned a lower return than call revenue. If an indirect access operator is able to take the most profitable streams of call revenue (long-distance and international) from a customer, BT's ability to earn profits from that customer is considerably reduced. One effect of indirect access is, therefore, that it encourages more economically efficient tariff structures.

15. However, BT's ability to raise exchange line rental charges has been constrained by a price cap of RPI+2% imposed by OFTEL. This reflected concerns about the impact on customers of very rapid rebalancing, particularly at a time when customers' ability to migrate to lower cost providers of direct connections was constrained by the lack of alternatives to BT. In recognition of this, arrangements were put in place enabling BT to levy 'Access Deficit Contributions' (ADCs) from other operators.

16. The Director General, with BT's agreement, has recently ended the cap on exchange line rental price increases, reflecting the increasingly competitive marketplace, and at the same time removed the ADC regime. However, there remain some instances where tariffs are significantly unbalanced. Customers on the BT Light User Scheme, in which the rental element is subsidised, are not permitted to use indirect access arrangements. In addition, BT has recently asked OFTEL to give its view on the acceptability of levying an additional fixed charge for use of indirect access on customers on other tariff packages with rentals below the level of the tariff used to monitor BT's compliance with its price control obligations. BT has made no specific proposal for such a charge, but the figure of 1 per calendar month has been mooted. BT appears to be able to do this within their licence, but OFTEL has made clear that whilst it has no objection in principle, it would consider the proposals very carefully, consulting with the industry, taking account of : the size of the levy in relation to prevailing tariffs and costs, the potential impact it would be likely to have on the market for 'efficient' entry by indirect access, any distortion that such a levy might cause, and any likely anti-competitive effect.

Equal access

17. Whilst OFTEL takes the view that BT should continue to provide indirect access to other operators, OFTEL has also reviewed the question of how that access should be effected. In particular, OFTEL has reviewed the case for requiring BT to introduce the 'equal access' facility described in paragraphs 8 and 9. Earlier discussion of equal access produced no clear consensus on whether it would deliver significant net benefits. OFTEL therefore concluded in 1994 that a full cost-benefit analysis should be undertaken in accordance with the provisions of condition 13A of BT's licence. NERA, a consultancy firm specialising in economic analysis, was asked to conduct the analysis. The terms of reference and findings of the study were discussed with the industry in draft.

NERA's methodology

18. NERA examined four different options, in each case in addition to customers remaining as they are, for implementing equal access:

Option 1 - pre-selection of an operator but with an override feature enabling the customer to make a different choice for any given call;

Option 2 - as above, but with the customer additionally being able to choose to make all calls on a call-by-call operator selection basis;

Option 3 - a customer to have the choice between pre-selection with no override, or call-by-call selection;

Option 4 - a customer to have call-by-call selection only.

Benefits of equal access

19. The benefits of equal access identified by NERA fell into two categories. First, what NERA describes as the 'Type 1' benefits, which are the direct benefits accruing to customers who opt to take service from an indirect operator because of the availability of equal access. These are the savings which they enjoy through lower call prices, better quality, more service features and increased ease of making calls through dialling fewer digits than a call-by-call selection would require. In order to measure these direct benefits, NERA looked at the likely impact of the various options on the scale of customer migration to indirect operators. NERA found that option 4, call-by call selection, because it involves customers dialling extra digits for all calls, was unlikely to be attractive to them and thus to offer little benefit. The options likely to deliver the most significant benefits were options 1 and 2, which allow customers to pre-select the operator, so that no extra dialling would be involved. Even here, though, the direct benefits were relatively small - around 20m over 10 years - because equal access would not be greatly more attractive to customers than the existing indirect access arrangements, with in both cases there being the need to dial extra digits. Option 3 had 7m 'Type 1' benefits.

20. Second, NERA looked at indirect benefits - 'Type 2' benefits - which would accrue to BT's customers as a result of equal access being introduced. These benefits would accrue because the

migration which equal access encourages leads to competitive pressure on existing operators. The impact of this pressure may take the form of lower prices, better quality of service or greater innovation. NERA estimated that, under options 1 and 2, these benefits would be in the region of 60m over ten years, 36m for option 3 and nil for option 4.

21. Some operators criticised the estimation of Type 2 benefits. BT argued that the methodology used was apt to overstate the benefits, whilst other respondents suggested that the benefits were understated by a considerable margin. In considering these responses, we noted that NERA had conducted a number of sensitivity tests of its findings. Unless extreme assumptions were made - such as an increase in the 'Type 2' benefits of 50% - NERA's overall conclusion on benefits held good and the figures produced by NERA for this study were likely to be of about the right order of magnitude.

Costs of equal access

22. Against these benefits, NERA estimated the gross costs of introducing equal access - including system development and staff costs as: 162m each for options 1 and 2, 160m for option 3; and 47m for option 4.

The net costs and benefits were thus:

* -83m each for options 1 and 2;
* -118m for option 3; and
* -47m for option 4.

Leaving aside option 4 which had no gross benefits, the effect of introducing equal access would be at least a net cost to the UK of some 83m over ten years.

OFTEL's conclusions on equal access

23. The NERA study raised doubts about the overall economic benefit of introducing equal access. In addition, OFTEL is concerned that its introduction could discourage operators from developing alternative access networks if they risked the benefits of their investments to competing operators. OFTEL concluded, on balance, that there is no case for directing BT to provide equal access. (In Hull, Kingston Communications only provides local calls and allows customers to choose alternative operators for long distance and international calls. However, this is a special situation as, for historic reasons, BT is not authorised to operate in Hull).

24. A number of respondents, whilst accepting that the cost-benefit analysis was broadly correct, commented that the result stemmed from the drafting of Condition 13A and the definition of equal access it contains. It was argued that the Condition rules out the form of equal access which generates the most significant benefits - in which customers are balloted on their choice of long-distance and international carrier, and those who do not respond are apportioned between operators. Our view is that the ballot approach might be appropriate where competition is being introduced into the market for the first time. But UK customers already have access to a range of competing services and are increasingly knowledgeable about them.

25. It has also been suggested that the scope of the Condition - focusing only on access to long-distance and international services - is too restrictive. It is argued that customers should have an entirely free choice of services irrespective of the network over which they are provided. This is really a different issue relating to allowing 'open access'. In fact, customers can, broadly speaking, have access now to all other operator's services from BT's network. However, as a general policy, open access would raise issues on infrastructure competition as operators would be discouraged from building new networks if there was a risk that they could not earn an appropriate return. For this reason, OFTEL has concluded that open access to non-dominant networks should not be pursued.

Extension of Indirect Access Arrangements to Non-Dominant Networks

26. The original focus of indirect access arrangements was in providing for BT customers to have access to other operators and given its dominance in direct connections to customers, BT remains the focus of indirect access policy. Nevertheless, the steady development of other operators' access networks suggests that it may be helpful for OFTEL to clarify its position on indirect access from non-dominant networks. Whilst, PTO's licences provide for indirect access, this is subject to a number of tests including the need to ensure that the requirements of fair competition are satisfied and that, in all the circumstances, indirect access is reasonably required.

27. The development of competing telecommunications infrastructure in recent years suggests that by encouraging local competition, the UK is creating one of the most competitive markets for telecoms in the world and is spreading competitive benefits to a wider cross-section of the community than has been achieved in other jurisdictions. The policy of encouraging competing infrastructure is now being followed or considered by many other countries.

28. A particular concern of OFTEL, therefore, is that companies entering the market, investing substantially in infrastructure and providing alternative direct connections to the trunk networks for customers, should not be exposed to cherry-picking by indirect access operators. Although there are pricing structures that new entrants could adopt to mitigate this problem, these pricing structures may result in reduced potential consumer welfare and slow down the provision of competing infrastructure. In addition, OFTEL's view is that, when applied to new networks, indirect access is likely to exploit the high initial costs experienced by such networks and discourage the development of competing infrastructure. Therefore, when considering the question of whether non-dominant operators should be required to provide indirect access, it remains of the view that this is generally undesirable.

29. OFTEL has considered the countervailing benefits to customers of having the greater freedom of choice. On examination, however, OFTEL considers that customers would enjoy this freedom of choice anyway provided that BT is mandated to provide access to such services. In other words, a customer who values the services offered by an indirect operator will be able to enjoy these services by remaining with or reverting to BT. If this is a very significant factor for customers, one might expect the lack of indirect access on non-dominant networks to constitute a disadvantage to those networks. Under these circumstances, other operators may themselves choose to make indirect access a feature of their networks.

30. There are some important caveats to these arguments. OFTEL is aware that some customers who migrate to other operators are unaware at the time that they will be unable to make use of other operators through indirect access. The extent to which this confers a material disadvantage on them is limited, given that, as noted above, they can switch back to BT if they place a particularly high value on that indirect access, and given that the imminent arrival of number portability on a large scale will remove much of the difficulty of that switching process. Nevertheless, this information shortfall could clearly be a source of irritation to some customers, and OFTEL intends to investigate what more could be done to raise awareness amongst customers of this issue as part of our project on "Prooting better customer information".

31. The second major caveat concerns the increased market share which currently non-dominant operators may be expected to gain in future. Some Conditions in non-dominant PTO licences may be triggered when the operator in question becomes 'well-established', a phrase which is defined as meaning that the operator has 25% or more of the 'relevant market'. 'Well-established' is not the same as 'dominant', but below 25% of a relevant market, we would consider it to be unlikely for an operator to be able to exercise significant market power or be viewed as well established.

32. OFTEL considers that a similar trigger threshold - 25% of customer connections in a relevant market - should usefully guide the Director General's consideration of requests to require that operator to provide indirect access. If an operator does not have 25% of the connections in a relevant market, OFTEL would be unlikely to conclude that indirect access should be required. If the operator did have 25% or more of connections, OFTEL would want to consider other market conditions, such as the share of connections held by other operators, the existence of any barriers to switching or whether, in the longer run, mandating indirect access under such circumstances was likely to enhance competition or diminish it. Consideration of these factors would create a framework in which a request to mandate indirect access could be considered.

33. OFTEL has also considered what would happen if the market develops such that a number of operators combined had obtained a significant market share although no individual operator other than BT exceeded 25%. In these circumstances, assuming BT remained dominant, OFTEL would continue to take the view that only BT should be mandated to provide indirect access as this would ensure that indirect access was available to the extent that customers require it.

Indirect access from public payphones

34. A third major caveat relates to indirect access from public payphones. The payphone market, whilst clearly linked to the telecoms market as a whole, has certain unique characteristics. In particular, OFTEL is concerned that customers using payphones may legitimately expect a minimum set of services, including forms of indirect access, to be provided from the payphone. On the other hand, the recent entry into the payphone market of a number of new companies, who might be expected to face the same entry barriers through high start-up costs, could suggest that again indirect access should not be mandated on their payphones. OFTEL will be consulting on what arrangements should apply to such operators in respect of the provision of services.

35. A number of operators have in recent times been offering substitute indirect access services behind 0800 or other free service numbers. OFTEL would take the same view of requests that

non-dominant operators be required to provide indirect access via such a mechanism as for the more usual means of a short access code.

Measures to Facilitate the Development of Indirect Access

Access to numbers

36. OFTEL is considering what measures might be adopted to remove barriers to the growth and delivery of indirect access services. One significant barrier could be the absence of suitable short number codes to facilitate indirect access. Under the current Numbering Scheme, codes assigned for 'choice of operator' purposes are designated 'Type B'. 270 such 4-digit codes are shown as free within the Numbering Scheme, but a number of these are not currently useable by customers on the BT network, because BT is currently using the codes for other purposes. Similarly, other operators, such as Vodafone, Orange and Telewest use some of these codes for other purposes. Overall this results in over 100 such 4-digit Access Codes being currently unavailable. Withdrawal of thee codes from their existing uses is being progressed with the operators concerned, so that the full 270 codes should be available for indirect access purposes.

37. Beyond this currently agreed action, there are number of areas for potential further action to make available additional 'Type B' codes. There are at present 4 3-digit Type B codes allocated: 131, 132, 133 (for access to Mercury) and 144 (for access to BT's chargecard), and one reserved for access to BT - 128. Clearly, if these codes were withdrawn and replaced with new 4 digit codes, this would make further access codes available. All these codes were allocated prior to OFTEL taking control of the Specified Numbering Scheme. In addition, OFTEL could take action to withdraw certain existing Type A and Type C codes for re-allocation as Type B codes.

38. Even if such action were taken, there would still be a finite number of suitable codes, and OFTEL would need to take a view on how eligibility for codes should be assessed. One argument would be that the unique value of short codes lies in the ability which they offer customers to access an alternative network with a minimal penalty in terms of having to dial extra digits.

39. OFTEL intends to pursue the question of what steps are necessary as respects withdrawal and re-allocation of existing codes in its review on numbering policy. The question of how requests for such codes will be prioritised will be discussed in that exercise and also in OFTEL's ongoing work on the future regulatory regime for Independent Service Providers.

Other barriers to indirect access

40. In the 'Residual barriers to competition' project, OFTEL is considering a number of issues which may potentially affect the ability of indirect access operators to compete successfully with BT. A number of operators have complained about the effect of BT's policy of charging operators for 'data management amendments', that is changes to the data held within the BT network which enables calls to be routed to other operators' numbers. In particular, OFTEL has received complaints about BT's DMA charges in respect of indirect access services behind '0800' and other service numbers. OFTEL considers that there may be a case for the sharing of some DMA costs between BT and other operators (although this principle is unlikely to extend to the setting up of 4-digit

indirect access codes themselves) and is consulting with the industry separately on these issues. It intends to reach initial conclusions on DMAs by September of this year, with a subsequent progress statement in December.

Direct Connection to the Access Network

41. BT continues to enjoy considerable benefits of scale and scope through having a UK wide Access Network. Ownership of the exchange line gives BT substantial control over the services delivered to customers. One way of overcoming this, would be to allow other operators to take over the exchange line at some convenient point. This would open up a number of opportunities for operators to compete with BT without the substantial investment needed to lay individual connections and without undue risk to the new operator.

42. Additionally, OFTEL has noted that the US Telecommunications Act 1996 has ended the local exchange monopoly in the States and provides for other operators to have unbundled access and connection to any feasible point in the Access Network. OFTEL understands that the motivation in the US is to encourage competitors to enter the local call market as quickly and smoothly as possible. The precise technical issues and charging arrangements have still to be determined.

43. Direct connection to the Access Network would mean that BT would lease the exchange line (or part of it) to a second operator. The other operator would then take over 'ownership' of BT's customer and it would convey all incoming and outgoing calls over what would now be its own network. The second operator's bills to customers would cover both call conveyance and exchange line rental.

44. The most convenient point to connect to the Access Network would probably be at BT's local exchange with calls being diverted at the Main Distribution Frame (MDF) to the second operator's switch which would be located in a nearby building (see diagram at Annex B). This would allow other operators to avoid the necessity of paying for the cost of the call being switched by BT (the bundling of which in current interconnect charges payable to BT has been subject to criticism by a number of parties). It is likely though that the second operator would still prefer to place some equipment in BT's local exchange premises.

45. Although OFTEL recognises that direct connection to the Access Network is feasible, it would run counter to the UK policy of encouraging alternative infrastructure. It would involve the leasing of part of BT's network at a regulated price to its competitors and hence would discourage rather than encourage operators to build their own Access Networks. It would undermine the value of the investment other operators, particularly cable companies, have made in building their own infrastructure to gain customers and hinder the development and upgrading of existing Access Networks.

46. The UK's aim is that all customers should have the choice of at least three operators. These might comprise BT, a cable operator, a radio access operator and/or an indirect access operator. For many residential customers, this is now a reality. In the major cities, specialist operators are starting to build their own Access Networks to connect large business customers and businesses often have a choice of several operators already. UK operators are likely to have invested 7 billion in building